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No. 03-772

Supreme Court, U.S.
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In the Supreme Court of the United States

AMERICAN GENERAL FINANCE, INC., AND MICHAEL J. ANDERSON,

Petitioners,

v.

MARY JEAN ASHBY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Alabama

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The brief in opposition confirms the significance of the issues presented in the petition for certiorari. Respondent *acknowledges* that, under the rule announced by the Alabama Supreme Court, *First Options* clauses will be unenforceable whenever the validity of an arbitration agreement is called into question – a holding that effectively makes it impossible for the parties to enter into binding agreements that commit the determination of arbitrability to the arbitrator. At the same time, respondent makes no attempt to defend the Alabama court's use of rules that single out arbitration contracts for uniquely unfavorable treatment. Because both aspects of the holding below are inconsistent with this Court's decisions and present recurring issues of great practical importance, further review is warranted.

A. An Arbitration Clause Providing That An Arbitrator Should Decide Issues Of Arbitrability Is Enforceable

1. Respondent correctly recognizes that, under the holding of the Alabama Supreme Court, a court (and not an arbitrator) must resolve any challenge to the "validity of an arbitration agreement" – even when the contract between the parties *expressly* commits resolution of such a challenge to the arbitrator. Br. in Opp. 13. See Pet. App. 11a ("[A] determination that, by the terms of the arbitration clause, the arbitrator is to decide issues of arbitrability does not end the inquiry. * * * [T]he threshold issue of unconscionability of an arbitration clause is a question for the court and not the arbitrator.") (internal quotation marks and citations omitted).[1]

[1] Although the decision below specifically involved a claim that the arbitration clause was unenforceable on unconscionability grounds, there is no denying that the language and logic of the

Respondent defends that holding by arguing that "this Court has drawn a sharp distinction between issues concerning the validity of an arbitration agreement, which a court must decide before it can order arbitration of a dispute, and other issues relating to contracts with arbitration provisions." Br. in Opp. 13.

But the Court has said nothing of the sort. To the contrary, the Court has indicated repeatedly (see Pet. 11 (citing cases)), and reaffirmed in *First Options of Chicago, Inc.* v. *Kaplan*, 514 U.S. 938 (1995), that "a court must defer to an *arbitrator's* arbitrability decision when the parties submitted that matter to arbitration" (*id.* at 943 (emphasis added)) – which is to say, when "there is 'clea[r] and unmistababl[e] evidence'" that "the parties agreed to arbitrate arbitrability." *Id.* at 944 (citation omitted). The Court has never suggested that this rule does not apply, and that such *First Options* clauses should not be enforced, when the "arbitrability decision" involves a question about the enforceability or validity of the arbitration clause. Indeed, as we noted in the petition (at 13 n.8), in *First Options* itself the parties seeking to avoid arbitration contended that the arbitration clause in that case was unenforceable as to them. Under the Alabama Supreme Court's rule, that contention automatically would have been resolved by a court. This Court, however, examined the record to see whether the contract contained a *First Options* clause and held that arbitration of arbitrability was inappropriate only because it did not. *Id.* at 946.

In departing from this Court's holdings, the contrary approach taken by the court below leads to extraordinary results. It renders express and unambiguous *First Options*

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court's holding apply to *any* contention that an arbitration agreement is unenforceable. See Pet. App. 10a ("a challenge to the arbitration clause only is properly determined by the court") (internal quotation marks and citations omitted).

clauses unenforceable in a great many circumstances, making it impossible for parties to contract to have arbitrators resolve questions regarding the validity or enforceability of arbitration agreements. Such an outcome runs directly counter to the "central purpose of the Federal Arbitration Act," which is "to ensure 'that private agreements to arbitrate are enforced according to their terms.'" *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (citation omitted). And the holding below is flatly inconsistent with the "liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1963).

2. The Court actually has drawn quite a different line from the one posited by respondent and the Alabama Supreme Court: as we noted in the petition (at 12-13), this Court's decisions indicate that a question of arbitrability that has been contractually committed to an arbitrator will be resolved by a court only when the question at issue is whether the parties agreed to arbitrate *at all*. The distinction, as Judge Easterbrook explained for the Seventh Circuit, is that between "a defense to enforcement" of the arbitration agreement, which must be resolved by the arbitrator in the presence of a *First Options* clause, and "a situation in which [it is claimed that] no contract came into being," which will be resolved by a court. *Sphere Drake Ins. Ltd.* v. *All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001). By allowing a judge to decide whether the parties in fact entered into an arbitration agreement, this distinction "avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate." *Howsam* v. *Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002).[2] And the Court's approach follows

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[2] "This Court has determined that 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *Howsam*, 537 U.S.

directly from the language of the FAA, which provides that a court *must* require arbitration "upon being satisfied that *the making of the agreement for arbitration* * * * is not in issue." 9 U.S.C. § 4 (emphasis added). See *Prima Paint Corp.* v. *Conklin Mfg. Co.*, 388 U.S. 395, 403-404 (1967) ("if the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the 'making' of the agreement to arbitrate – the federal court may proceed to adjudicate it").[3]

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at 83 (quoting *Steelworkers* v. *Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582 (1960)). As a consequence, a claim that a party never agreed to arbitration must be decided by a judge; "an argument that the contract does not exist can't logically be decided by the arbitrator." *Sphere Drake*, 256 F.3d at 591. But that logical problem is not presented here – and it *is* "possible to arbitrate * * * without circularity" (*ibid.*) – when the parties have agreed to have an arbitrator decide a particular issue. As we explained in the petition (at 12-13), that is so even when the validity of the arbitration agreement is called into question.

[3] Respondent relies on the Court's dictum in *Prima Paint* that "a claim of fraud in the inducement of an arbitration clause itself is for a court to decide under the FAA." Br. in Opp. 13. But that observation does respondent no good. The contract in *Prima Paint* did not contain a *First Options* clause; in light of *First Options*, *Prima Paint* cannot be read to establish that such clauses are unenforceable whenever the validity of the broader arbitration agreement in which they appear is questioned. And to the extent that *Prima Paint* is thought to "sit[] uneasily alongside" *First Options*, as Judge Easterbrook suggested (*Sphere Drake*, 256 F.3d at 590), the tension surely should be resolved by this Court and not by the Supreme Court of Alabama. Moreover, as we note in text, the Court in *Prima Paint* observed that fraud in the inducement of an arbitration agreement calls into question the "making" of the contract within the meaning of § 4 of the FAA; in contrast, a claim of unconscionability that is advanced as a defense to enforcement of a

Here, it is indisputable (and it is not disputed by respondent) that claims of contract invalidity of the sort addressed by the Alabama Supreme Court state a *defense* to enforcement of a consummated arbitration agreement rather than an assertion that a contract was never "made." After all, the Alabama Supreme Court premised its holding of contract unconscionability on the understanding that a contract between the parties *does* exist; the court explained that "'Alabama has long recognized the doctrine of unconscionability as a defense to enforcement of a contract.'" Pet. App. 10a (citation omitted). Thus, the Alabama statute relied upon by the courts below and cited by respondent expressly refers to contracts that have been "made" and makes unconscionability a defense that may preclude or limit *enforcement* of that contract. Ala. Code 1975, § 5-19-16. The Alabama Supreme Court's decision that a *First Options* clause is unenforceable in such circumstances cannot possibly be reconciled with this Court's holdings.[4]

3. Respondent also is wrong in asserting that the decision below is "fact-specific." Br. in Opp. 11. The Alabama Supreme Court unambiguously set down a legal rule that determined the outcome here: "[T]he threshold issue of unconscionability of an *arbitration clause* is a question for

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contract that was voluntarily and knowingly signed by a party does *not* "go[] to the 'making' of the agreement to arbitrate."

[4] Respondent also is incorrect in denying that the decision is inconsistent with the holdings of various federal courts of appeals cited at Pet. 15-18. See Br. in Opp. 15-18. Those decisions held that, in the presence of a *First Options* clause, arbitrators should decide whether arbitration clauses are enforceable. The decisions cannot be reconciled with the principle upon which the Alabama Supreme Court rested its decision: that "a challenge to the arbitration clause * * * is properly determined by the court." Pet. App. 10a (internal quotation marks and citations omitted).

the court and not the arbitrator," whether or not "the terms of the arbitration clause [require] the arbitrator * * * to decide issues of arbitrability." Pet. App. 11a (internal quotation marks and citations omitted; emphasis in original). See *id.* at 10a ("a challenge to the arbitration clause only is properly determined by the court") (internal quotation marks and citations omitted). That holding has nothing to do with the facts of this case and will govern whenever a party to a contract containing a *First Options* clause contests the enforceability or validity of the agreement to arbitrate.

Moreover, as we showed in the petition – and as respondent does not deny – the rule announced by the Alabama Supreme Court involves a recurring issue of great practical importance. *First Options* clauses appear in innumerable consumer, business-to-business, and employer/employee arbitration agreements across the Nation. See Pet. 26-28 & nn. 17-19. The decision below makes such clauses unenforceable in Alabama in a great many circumstances – and gives any party that seeks to escape from an arbitration agreement an opportunity to obtain a hearing before a potentially sympathetic local judicial forum. The inevitable result will be dashed commercial expectations, uncertainty, and the very sort of wasteful litigation that Congress sought to avoid when it enacted the FAA and put in place a "federal policy favoring arbitration." *Mastrobuono*, 514 U.S. at 62.

B. The Alabama Supreme Court Subjected Arbitration Contracts To Uniquely Unfavorable Treatment

Respondent makes no serious attempt to respond to the second issue advanced in the petition: that the Alabama Supreme Court announced rules that subject arbitration agreements to uniquely unfavorable treatment. We noted in the petition that the court below held (1) that *First Options* clauses are *themselves* inherent indicia of contract uncon-

scionability and (2) that "the breadth of an arbitration agreement" likewise is *itself* a basis for finding the agreement unconscionable. Pet. 20-21. On the face of it, as we explained in the petition, these rules are insupportable because they can apply *only* to arbitration clauses and thus take their "'meaning precisely from the fact that a contract to arbitrate is at issue.'" *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 685 (1996) (citation omitted). Respondent offers no response at all to this point and does not attempt to defend this aspect of the holding below.[5] Because that holding departs from this Court's decisions and will serve as a model for other courts that are hostile to arbitration, further review is warranted.

Although respondent thus ignores the most obviously flawed aspects of the holding below, she does argue that generally applicable Alabama law allowed the Alabama Supreme Court to consider the "market prevalence" of

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[5] Respondent tries to minimize the extent to which the Alabama Supreme Court singled out arbitration agreements by contending that "it was not the fact that the Ashbys were required to arbitrate all of their disputes that troubled the court, but rather the one-sided nature of a provision that limited the Ashbys to arbitration * * * while giving [petitioner] the choice of *either* an arbitral or judicial forum." Br. in Opp. 22 (emphasis in original). This contention, however, rests on a plain misreading of the decision below. The court identified the arbitration clause's asserted one-sidedness and lack of mutuality as a *separate* indicium of unconscionability. See Pet. App. 16a (pointing to "the provision reserving to American General Finance the right to a trial by jury while mandating that the Ashbys arbitrate any and every claim that might arise" as the third of four indicia of unconscionability). There is no doubt that the court singled out the "breadth of the arbitration agreement" and the inclusion of a "provision purporting to invest the arbitrator with [deciding] the threshold issue of arbitrability" as the first two of four stand-alone grounds for finding the contract unconscionable. *Ibid.* See Pet. 20-21.

arbitration agreements as an aspect of its unconscionability analysis. Br. in Opp. 20-21. Respondent misses the point. Whatever Alabama law may have to say in general on the subject of "prevalence," the FAA makes it federal policy to *encourage* the use of arbitration agreements – so much so, as we noted in the petition (at 23), that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25. By holding that the widespread use of arbitration clauses tends to establish the unconscionability of arbitral agreements, the court below penalizes the use of such provisions, discourages their inclusion in contracts, and frustrates the plain goal of the FAA.

Respondent also takes issue with the suggestion that the decision below is a manifestation of the Alabama courts' hostility to arbitration. Br. in Opp. 26. Of course, we do not contend that the Alabama courts refuse to enforce any and all arbitration agreements. But the statement that Alabama has been "historically hostile to arbitration" is not ours; the petition repeated the recent observations to that effect offered by neutral commentators. See Pet. 28-29. In any event, whatever its motivation, a decision that undercuts federal law and departs from this Court's holdings should not stand.

C. The Decision Below States An Important Legal Rule That Should Be Reviewed By This Court

Finally, respondent is wrong in contending that review is unwarranted because the court below could have held that the arbitration agreement was unenforceable on the ground that she was unaware of it. Br. in Opp. 26-27. The simple answer to this argument is that the Alabama court did not so hold. Its refusal to premise its decision on respondent's purported lack of knowledge of the arbitration clause plainly was deliberate. As we noted in the petition (at 14 n.9), the court held that respondent's husband *was* entitled to a trial to determine

whether he was aware that he had signed an arbitration clause in connection with his separate insurance contract (see Pet. App. 23a n.9, 23a-30a); in pointed contrast, the court did *not* base its decision to have a judge decide the arbitrability of respondent's contract on her degree of knowledge regarding the contract's terms. Respondent's speculation that the court could have done so does not provide a ground for denying the petition – particularly when the court's *actual* holding unquestionably states a broad legal rule that will govern the validity of *First Options* clauses in all future cases arising in Alabama.

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari to the Supreme Court of Alabama should be granted.

Respectfully submitted.

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